

MALDIVES MONETARY AUTHORITY

PRUDENTIAL REGULATION

No. 03-2009

LIMITS ON LOANS TO RELATED PERSONS

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PART I: PRELIMINARY

- 1: Short Title** – Loans to related persons.
- 2: Authorization** – The Maldives Monetary Authority (MMA) is authorized to issue regulations under Art. 36 read with Art. 29-34 of the MMA Act 1981 (MMA Act) in relation to prudential matters to be complied with by all banks and deposit-taking institutions (collectively 'banks'), or other persons as the regulation may specify.
- 3: Application** – All banks and deposit-taking institutions licensed by the MMA to conduct banking business in the Maldives.
- 4: Definitions** – Terms used within this regulation are as defined in the Act, as defined below, or as reasonably implied by contextual usage:
- (1) "**administrator**" – means any person who is a director, executive officer, or member of the audit committee of a bank, including, in the case of a foreign bank, a designated branch manager and other officers who hold a position of executive officer as the term is defined below.
- (2) "**associate**" – means any person over whom another person exerts or has the ability to exert significant influence and who is not a subsidiary of the first person; also referred to as an "affiliate" or "affiliated person". (See also International Accounting Standard IAS-28 or successor standards).
- (3) "**bank**" – means all banks and deposit-taking institutions licensed by the MMA to conduct banking business in the Maldives.
- (4) "**capital base**" – means Total Capital as defined in Capital Adequacy Regulation issued by the MMA.
- (5) "**current market value**" – means that value determined by using valuation methods appropriate to the type of property being evaluated. For commercial and multi-use properties (combined residential/rental/commercial), current market value is the average of values determined using the (i) comparable sales approach, (ii) cost approach and (iii) income (discounted cash flows) approach; for residential property (mainly owner-occupied/non-rental) the value is the average of values determined by using the comparable sales and cost approaches. The insured/insurable amount of property held as collateral is not acceptable as a substitute for current market value. The determination of current market value must be documented in writing, show assumptions, analyses and conclusions used, and be available for review by the MMA. As used herein, the term "current" means within a period of 12 months.
- (6) "**executive officer**" – means a person who is an employee of a bank licensed to conduct banking operations in the Maldives who, regardless of title, participates in policy-making functions, or is responsible for any material portion of the business activities of the bank, or is authorized to commit the bank's funds by making loans or investments. The term includes, but is not limited to, the chairman of the board, the president, the managing director, every vice president, and the treasurer of a bank.
- (7) "**exposure**" – means any loan, advance or credit exposure, whether direct or indirect, funded or unfunded, including obligations as maker or endorser arising from the discounting of commercial paper, given to a person on the basis of an obligation to

repay or which is repayable from specific property pledged by or on behalf of a person; funded exposures are those for which loan proceeds have been provided to the borrower or to a third party on behalf of the borrower; unfunded exposures are those for which loan proceeds have not yet been provided but the bank is legally obligated to do so on a specified future date or event.

(8) "**loans**" – means the same as exposures unless defined otherwise in text.

(9) "**net realizable value**" – means that amount which a bank can reasonably expect to realize after discounting the value of collateral to current market conditions and deducting the reasonable and estimable costs of recovery and sale. Costs of recovery and sale typically include, but are not limited to: legal fees, appraisal costs, sales fees, insurance cover, maintenance, security, and any other expenses necessary to put the collateral in a saleable condition. Net realizable value must be documented in writing, show assumptions, analyses and conclusions, and be available for review by MMA.

(10) "**person**" – means a natural person, company, corporation, associate, trust, joint venture, partnership or other business enterprise.

(11) "**qualifying holding**" – means a direct or indirect holding by a person acting alone or through or in concert with one or more other persons in an undertaking which represents 10% or more of the voting rights or which makes it possible to exercise significant influence over the management of the undertaking in which the holding exists, as the MMA may determine.

(12) "**related person**" – means (a) any administrator of the bank, (b) any person who is related to an administrator by marriage, blood or kinship up to the second degree, including children of the administrator, and any other person residing in the administrator's household who is dependent on the administrator for his support, (c) any person who has a qualifying holding in the bank, and any undertaking in which any such person or any administrator of the bank has a qualifying holding, and any administrator of such person or undertaking, and (d) any undertaking, not subject to consolidation in the preparation of financial statements of the bank, in which the bank holds a qualifying holding, and any administrator of such undertaking. For purposes of this regulation, any employee of a bank is also considered a related person.

Two or more persons will be considered to be related if one person has the ability, directly or indirectly, to control the other person/s or to exercise significant influence over the financial and operating decisions of the other person/s, or if both persons are subject to common control or common significant influence.

(13) "**subsidiary**" – means any legal entity in which another person or group of persons acting in concert holds 50% or more of the voting shares or any other holding that permits such other person or group of persons to exercise effective control over the management or policies of the legal entity in which the holding exists.

PART II: STATEMENT OF POLICY

- 1: Purpose** – This regulation is intended to prevent a bank from granting imprudent or excessive loans to related persons, individually and in the aggregate, relative to the bank's capital base. This regulation is also intended to assure that all loans made to related persons of a bank are on substantially the same terms and conditions as loans to non-related borrowers.

- 2: **Scope** – This regulation applies to all banks licensed and operating in the Maldives and to any loan by a bank to a related person, to a bank holding company of which the lending bank is a subsidiary, and to any other affiliate of the bank or its holding company. This regulation also applies to any loans by a bank to a company or the business enterprise that is controlled by a related person or to another person for the direct benefit of a related person.
- 3: **Responsibility** – It is the responsibility of the board of directors of each bank to establish policies and procedures to ensure that all exposures to related persons (a) fully comply with the limitations set forth in the Act and in this regulation, and (b) are made and administered according to prudent lending practices.

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

- 1: **Limits and Requirements** - The following limits and prohibitions shall apply:
- (a) **Basic limit:** the total of all loans outstanding to any one related person shall not at any time exceed 15% of a bank's capital base.
- (b) **Aggregate limit:** the total of all loans to all related persons of the bank shall not at any time exceed 50% of a bank's capital base.
- (c) **Security:** all loans to related persons shall be fully secured at all times, provided that loans to any one related person that do not, in the aggregate, exceed 2% of the bank's capital base, are exempt from this requirement. For purposes of this regulation, "fully secured" means that the combined principal and accrued interest for all loans is less than the net realizable value of the security as defined in this regulation.
- (d) **Terms and creditworthiness:** all loans to related persons (i) shall be on the same terms and conditions, including interest rates, fees, margins and security, as those applicable at the time of origination to similar loans to any other person who is not a related person of the bank, (ii) shall not involve more than the normal risk of repayment or any other unfavourable features, and (iii) the bank shall apply credit underwriting procedures that are no less stringent than those applied for comparable transactions with persons who are not related persons.
- (e) **Exceptions:** notwithstanding the limits and requirements immediately preceding, the following exceptions shall apply:
- i) **correspondent deposit accounts** – the limits and requirements of paragraphs (a)-(d) shall not apply to a deposit account maintained in the ordinary course of business by a bank in another bank that is (1) the controlling shareholder of the depositing bank, or (2) a subsidiary of the holding company of which the depositing bank is also a subsidiary;
- ii) **direct on-lending** – the limits and requirements of paragraphs (a)-(d) shall not apply to loans made in the ordinary course of business to a subsidiary bank or another financial institution for the purpose of direct on-lending to one or more counterparties who are not related to the bank.
- iii) **concessionary rates of interest** – a bank may make loans at concessionary rates of interest to any person who is an employee of the bank (but not to a non-executive director or to a company, partnership or joint venture owned or

controlled by an employee) provided that the loan is made in accordance with a defined employee benefits-compensation policy. For this exception to apply, the policy must:

- (A) be in writing and formally adopted by the board of directors;
- (B) apply equally to all employees of the bank and not give preference to any one or more persons or classes over other employees;
- (C) allow only for a concessionary interest rate (i.e. price) but not for any concessions in respect of credit underwriting standards (i.e. quality);
- (D) restrict the loan purpose to (1) purchase or improvement of the residence of the employee, (2) educational or medical expenses, or (3) personal and household expenditures for private, non-commercial purposes;
- (E) restrict the total outstanding balance of loans made to an employee at concessionary rates to the lesser of (1) three times the employee's annual cash compensation (i.e. salary plus cash bonus) in the prior calendar year, or (2) Rf 1,000,000, but in no event shall such total balance exceed 15% of the bank's capital base;
- (F) require that all other terms and conditions (i.e. repayment terms, types of collateral, security margins, income requirements, etc.) must be no more favourable than for similar loans to persons who are not related parties; and
- (G) comply, in form and substance, with all applicable laws and regulations of the MMA.

(f) **Prior board approval:** if the total of any new loan plus all other loans outstanding to a related person will exceed 5% of the bank's capital base, then: (i) all existing loans must first be acknowledged by the board of directors; (ii) the proposed new loan must be approved in advance by a majority of the full board of directors; and (iii) the related person must abstain from participating directly or indirectly in the voting process. Participating in discussions or any other attempt to influence the decision of the board regarding a loan to an related person shall constitute indirect participation in the decision process.

(g) **Determination:** the MMA will have sole discretion to decide whether a person is considered a related person and subject to the limits and requirements above.

2: Nonconforming loans - (a) if a loan to an related person complies to the requirements in paragraph 1 when made but later fails to comply because (i) the bank's capital base declines, (ii) the bank merges with another bank that also has loans to the related person, (iii) the lending limit or capital base rules change, or (iv) the security for the loan fails to satisfy paragraph 1(c), then the loan will be considered 'nonconforming'.

(b) if an exposure to an insider becomes 'nonconforming' for reasons (i, ii or iii) above, then the bank shall promptly take all reasonable actions to bring the exposure into compliance unless doing so would be inconsistent with safe and sound banking practices, in which case a majority of the board of directors shall give its approval for not taking actions and shall document the reasons in the minutes of the board.

(c) if an exposure becomes 'nonconforming' for reason (iv), then the bank must bring the exposure into compliance within 10 calendar days, unless judicial proceedings, regulatory actions, or other circumstances beyond bank control prevent taking action.

3: Reports by directors and executive officers - (a) every director and every executive officer of a bank who becomes indebted to any other bank/s in an aggregate amount greater than 5% of the capital base of the bank where he is a director or executive

officer, shall make a written report to the board of directors of the bank where he is a director or executive officer within 10 days after exceeding the 5% level. Such report shall provide, at a minimum, the following details: (i) the names of all banks to which the officer is indebted; (ii) the date, amount, terms and security for each loan; (iii) the use of proceeds and source of repayment for each loan; and (iv) the current balance and repayment status of the loan/s.

(b) every director and every executive officer of a bank shall submit a report to the board of directors of the bank where he is a director or executive officer annually by not later than 15th January detailing the: (i) the names of all financial institutions, domestic or foreign, to which he is indebted as at 31st December of the year immediately preceding; (ii) the original amount/s and current outstanding balance/s of such loan/s, (iii) the purpose of such loan/s; and (iv) whether repayments are current on the loan/s.

For purposes of item (b)(ii) above, it will be acceptable to show loan amount/s in the following size ranges: Rf 0-100,000; Rf 100,001-500,000; Rf 500,001-1,000,000; and <Rf 1 million. For purposes of (b)(iii) above, the loan purpose may be described in general terms, i.e. to purchase/ refinance/remodel home, to purchase securities or investments, to purchase vehicle, to pay personal, medical or education expenses, etc. For (b)(iv), the current status of loan repayments may be shown using the criteria Pass, OLEM, Substandard, Doubtful or Loss as prescribed in MMA regulation.

4. **Reports by publicly-traded banks** - if the shares of a bank are traded on a public stock exchange, and if a related person directly or indirectly owns, controls, or has the power to vote 10% or more of the ordinary shares of the bank, then the bank shall disclose in its annual external audit report (i) the name of the related person, (ii) the total principal balance of all loans outstanding to that person on the audit date, and (iii) the total of such loans expressed as a percentage of the bank's capital base.
- 5: **Reporting requirements.** Each bank shall submit to the MMA such returns as the MMA may require and in the form and frequency as the MMA may prescribe.

PART IV: CORRECTIVE MEASURES

- 1: **Remedial measures and sanctions** – If a bank, its directors or managers violate any provision of this regulation in a willful, negligent or flagrant manner which results, or threatens to result, in an unsafe or unsound condition of the bank or that threatens the interests of depositors, creditors or the general public, or if the bank, its directors or managers fail to comply with the instructions and reporting requirements in this regulation, the MMA may take any one or more of the corrective measures or impose any administrative penalties as provided in the MMA Act. Such measures and penalties may include, but are not limited to, any or all following –
 - (a) Issue a warning to the bank;
 - (b) Enter into an informal agreement with the bank for correcting violations and any unsafe and unsound practices and conditions;
 - (c) Issue an order to the bank requiring it to cease and desist from particular actions and further to take affirmative actions to correct violations and any unsafe & unsound practices and conditions;
 - (d) Require the board of directors to inject additional capital funds;

- (e) Restrict the scope of activities of the bank including imposing limitations on any foreign exchange activities, granting of credit, making of investments, acceptance of deposits, borrowing of money, or other activities as the MMA may deem appropriate;
- (f) Suspend access to the credit facilities of the MMA;
- (g) Suspend or require the removal of any directors, executive officers or managers;
- (h) Appoint an advisor or a conservator;
- (i) Impose an administrative penalty on the bank or any of its directors, executive officers or managers; or
- (j) Hold personally liable and seek restitution from, as the law allows, any directors, executive officers or major shareholders of the bank; or
- (k) Suspend or revoke the bank's license.

PART V: EFFECTIVE DATE

- 1:** **Effective date** – This regulation shall come into effect on 18th May 2009

 - 2:** **Supersedence** – This regulation supersedes paragraphs 9(1)(c) and (d) of the MMA Regulations for Banks and Financial Institutions (July 1, 1988) and will remain in effect until superseded or replaced by the Banking Law of the Republic of Maldives. In case of conflicting provisions or interpretations between this regulation and any portion of the earlier regulation, this regulation shall take precedence.
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Questions relating to this regulation should be addressed to the Senior Executive Director, Financial Sector Division, Maldives Monetary Authority.